

Letter of Findings: 10-0221
Sales and Use Tax
For the Years 2001-2009

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ISSUES

I. Sales Tax – Imposition.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-1-21; IC § 6-2.5-2-1; IC § 6-2.5-4-10; IC § 6-2.5-13-1; IC § 6-8.1-5-1; [45 IAC 1.1-2-10](#); [45 IAC 2.2-2-1](#); [45 IAC 2.2-4-27](#); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayer protests the imposition of sales and use tax on some items.

II. Tax Administration—Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of a ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer registered with the State of Indiana as a limited liability company (LLC) in August 2000. Taxpayer first reported business activity by filing Indiana partnership tax returns with the Indiana Department of Revenue (Department) for the 2001 tax year. The taxpayer's federal returns describe the taxpayer's business activity as the leasing of medical equipment. Taxpayer's returns indicate that taxpayer has engaged in retail activity since its first year of business, commencing in January 2001. Taxpayer did not register with Indiana as a retail merchant.

The Department conducted a sales and use tax investigation of taxpayer for the 2001 through 2008 tax years. That investigation resulted in Department assessments of sales and use tax for 2001 through 2008; the Department further issued a sales and use tax assessment, based upon "best information available," for the 2009 tax year (2001 through 2009 collectively the "Tax Years"). Taxpayer protested the respective assessments. A hearing was held on the protest. This Letter of Findings results. Additional facts will be provided as necessary.

I. Sales Tax – Imposition.

DISCUSSION

The Department's investigation found that taxpayer failed to remit sales tax to Indiana on lease transactions between taxpayer and its only lessee. The Department found that taxpayer and its lessee share common ownership: taxpayer is owned by doctors who also hold ownership interests in the lessee. Taxpayer did not invoice its lessee on a monthly basis, and could only produce copies of documents entitled "lease agreements" for some of the transactions; most of the agreements did not contain signatures from either lessor or lessee. The provision in the lease agreement addressing the monthly payments did not also address sales tax. The Department made its assessment pursuant to [45 IAC 2.2-2-1](#) generally, and [45 IAC 2.2-4-27](#) specifically, which imposes a sales tax on the rental of tangible personal property in Indiana.

All tax assessments are prima facie evidence that the Department's claim for the tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

"An excise tax, known as the state gross income tax, is imposed on retail transactions made in Indiana." IC § 6-2.5-2-1(a). A "retail transaction" is defined in IC § 6-2.5-1-2 as "a transaction of a retail merchant that constitutes selling at retail[.]" "A person... is a retail merchant making a retail transaction when he rents or leases tangible personal property to another person." IC § 6-2.5-4-10(a).

IC § 6-2.5-2-1(b) provides that:

The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

IC § 6-2.5-4-10(b) provides that:

(b) A person is a retail merchant making a retail transaction when the person sells any tangible personal property which has been rented or leased in the regular course of the person's rental or leasing business.

[45 IAC 2.2-4-27](#) states in relevant part:

(a) In general, the gross receipts from renting or leasing tangible personal property are taxable. This regulation [[45 IAC 2.2](#)] only exempts from tax those transactions which would have been exempt in an equivalent sales transaction.

(b) Every person engaged in the business of the rental or leasing of tangible personal property, other than a public utility, shall be deemed to be a retail merchant in respect thereto and such rental or leasing transaction shall constitute a retail transaction subject to the state gross retail tax on the amount of the actual receipts

from such rental or leasing.

(c) In general, the gross receipts from renting or leasing tangible personal property are subject to tax. The rental or leasing of tangible personal property constitutes a retail transaction, and every lessor is a retail merchant with respect to such transactions. The lessor must collect and remit the gross retail tax or use tax on the amount of actual receipts as agent for the state of Indiana. The tax is borne by the lessee, except when the lessee is otherwise exempt from taxation.

(d) The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.

(1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.

(2) Rental or lease period. For purposes of the imposition of the gross retail tax or use tax on rental or leasing transactions, each period for which a rental is payable shall be considered a complete transaction. In the case of a weekly rate, each week shall be considered a complete transaction. In the case of a continuing lease or contract, with or without a definite expiration date, where rental payments are to be made monthly or on some other periodic basis, each payment period shall be considered a completed transaction.

In taxpayer's protest, taxpayer asserts that the subject transactions do not constitute leases. Specifically, taxpayer cites IC § 6-2.5-1-21(a)(2) for the proposition that the definition of "lease" or "rental" does not include:

A transfer of possession or control of property under an agreement that requires the transfer of title upon completion of required payments and payment of an option price that does not exceed the greater of one hundred dollars (\$100) or one percent (1[percent]) of the total required payments[.]

Taxpayer points to language in the lease agreements that allow the lessee, after payment of all "monthly rentals," the option of purchasing the leased piece of equipment for one (1) dollar.

If the lease requires the transfer of title upon completion of required periodic payments and payment of an option price that does not exceed the greater of one hundred dollars (\$100) or one percent (1[percent]) of the total required payments, then there is no valid lease agreement, and the transaction is treated as a sale. IC § 6-2.5-1-21(a)(2). The cited statute applies to those Tax Years from 2004 through 2009, but proves dispositive in an analysis of the terms and conditions of the subject transactions for the 2001, 2002, and 2003 tax years. Taxpayer's copies of alleged lease agreements give the lessee the option of receiving title to specified medical equipment upon completion of required monthly payments and a final payment significantly less than the monthly payment.

If, pursuant to IC § 6-2.5-13-1, the sale is sourced to Indiana, the retail merchant must collect and subsequently remit sales tax at the time of the sale based on the gross retail income received by the retail merchant, unless the purchaser presents the retail merchant with an exemption certificate. To enjoy an exemption from Indiana sales tax, the purchaser must present the retail merchant with a valid Form ST-105. Taxpayer did not present copies of any Form ST-105s, or any other documents showing an exemption request or other reason for exemption from sales tax.

Taxpayer argues that it acquired some of the subject equipment via capital contribution, casual sales or by other means. Therefore, taxpayer repeats its assertion that the transactions do not fit within the statutory language of what constitutes a lease. If, as taxpayer maintains, the equipment transactions were capital leases, the transactions created financing arrangements and not leases and the sales tax is due on the purchase price of each piece of equipment at the beginning of the respective transactions. Taxpayer did not provide copies of any invoices or other purchase documents showing payment of sales tax on the subject medical items.

[45 IAC 1.1-2-10](#) establishes a standard for determining if a lease agreement "is a financing device for a sale of tangible personal property...." Under that regulation, "[t]he department will consider many factors in determining the intent of the parties, including the following:

- (1) Whether the lease payments are to be applied to any equity to be acquired by the lessee.
- (2) Whether the lessee will acquire title to the goods upon the lessor's receipt of a stated amount of payments under the contract.
- (3) Whether the total lease payments for a relatively short period of use make up an inordinately large proportion of the total payments needed for the lessee to secure title.
- (4) Whether the lease payments exceed the current fair rental value of like goods.
- (5) Whether the lease contains an option to buy at a price nominal in comparison to the value of the property when the option may be exercised.
- (6) Whether a part of the lease payments is designated or recognizable as interest or its equivalent. Id.

As stated previously, taxpayer's lease agreements include a provision by which the lessee may exercise an option to purchase the leased equipment for one dollar upon payment of all monthly rentals. Taxpayer points to

this provision to assert qualification under [45 IAC 1.1-2-10](#) based upon one of the six factors suggested. Taxpayer also asserts that taxpayer's lease agreements provide a means by which the lease payments are effectively applied to the equity acquired by the lessee. [45 IAC 1.1-2-10\(c\)\(1\)](#).

Taxpayer cites the Department's Letter of Findings No. 00-0056 ("LOF 00-0056") as a basis for its financing arrangement analysis. The Department reminds taxpayer that each letter of findings or other document issued as a result of an administrative hearing or procedure relies on facts and circumstances specific to a particular taxpayer. A comparison between taxpayer's facts and circumstances and those of the taxpayers in LOF 00-0056 finds that the subject taxpayer's analysis falls short of favorable consideration of "many factors in determining the intent of the parties." [45 IAC 1.1-2-10\(c\)](#). Taxpayer did not present any evidence demonstrating that taxpayer's transactions mimic description of the transactions, arrangement, or the corresponding facts and circumstances provided in the cited letter of findings. Therefore, taxpayer has not met its burden of proof with respect to satisfaction of [45 IAC 1.1-2-10](#).

[45 IAC 2.2-4-27\(d\)\(2\)](#) clearly states that each billing period of a rental represents the period for a complete transaction. Therefore, the subsequent billings to taxpayer's customer in Indiana are indeed separate, consecutive transactions that take place in Indiana and are therefore subject to Indiana sales tax. Taxpayer has not provided evidence sufficient to overcome the Department's assessment of Indiana sales tax on these transactions.

FINDING

Taxpayer's protest is respectfully denied.

II. Tax Administration—Negligence Penalty.

DISCUSSION

The Department issued proposed assessments and the ten percent negligence penalty for the Tax Years. Taxpayer protests the imposition of penalty. The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

...

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

...

the person is subject to a penalty.

The Department refers to [45 IAC 15-11-2\(b\)](#), which states:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

[45 IAC 15-11-2\(c\)](#) provides in pertinent part:

The department shall waive the negligence penalty imposed under [\[IC 6-8.1-10-2.1\]](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, taxpayer incurred deficiencies which the Department determined were due to negligence under [45 IAC 15-11-2\(b\)](#), and so was subject to a penalty under IC § 6-8.1-10-2.1(a). In taxpayer's protest, taxpayer has affirmatively established that taxpayer had reasonable cause and was not negligent, as required by [45 IAC 15-11-2\(c\)](#).

FINDING

Taxpayer's protest of the imposition of penalty is sustained.

CONCLUSION

In summary, Taxpayer's protest of the sales and use tax assessment for the Tax Years is denied; and Taxpayer's protest of the penalty is sustained.

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